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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket 92-266
	)	
Rate Regulation	)	

DISCOVERY COMMUNICATIONS, INC.
PETITION FOR RECONSIDERATION

Judith A. McHale
Senior Vice President and
General Counsel
Barbara S. Wellbery
Vice President and
Deputy General Counsel

DISCOVERY COMMUNICATIONS, INC.
7700 Wisconsin Ave.
Bethesda, MD 20814

Richard E. Wiley
Philip V. Permut
Lawrence W. Secrest, III
William B. Baker

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

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PETITION FOR RECONSIDERATION

Discovery Communications, Inc. ("Discovery"), by its attorneys, and puruant to Section 1.429 of the Commission's rules, hereby submits this Petition for Reconsideration ("Petition") of the Commission's Report and Order and Further Notice of Proposed Rulemaking to implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("Cable Act").[1] Discovery submits this Petition out of a conviction that the Commission's *Order* if left unchanged will seriously harm the cable programming industry and thereby undermine a primary goal of the Cable Act: the promotion of consumer access to a wide diversity of programming choices.

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[1] Report and Order and Further Notice of Proposed Rulemaking, Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, FCC 93-177 (released May 3, 1993) ("*Order*").

I. INTRODUCTION.

As explained in its opening comments in this proceeding, Discovery operates The Discovery Channel and The Learning Channel. As a provider of video programming, Discovery will be substantially affected by the rules and policies established in the *Order*. Cable rate regulation not only directly affects the price subscribers pay for programming, but indirectly the access consumers have to a wide diversity of programming choices. Accordingly, Discovery has a vital interest in seeking to ensure that the Commission's implementation of cable rate regulation does not stifle innovation in cable services and, in fact, provides proper and sufficient incentives for cable operators to make available new program services.

While obviously not its intention, the Commission's *Order*, with its benchmark and price cap mechanisms, already has led to a freeze in the cable programming market. Discovery has held discussions with numerous cable operators around the country in the past year seeking to increase the distribution of The Learning Channel. Since the adoption of the *Order* in April, however, these discussions have become futile. Cable operators, even those that appeared interested in adding The Learning Channel prior to the Commission's *Order*, are now simply not interested in adding new channels, such as The Learning Channel, to their systems, except on an unregulated basis.

Cable operators have offered to reasons for this change: first, they are concerned with the effects of the FCC's new regulations; second, they see no economic incentive to add new program services or to increase channel capacity. The FCC-mandated rate reductions have caused cable operators to review their business activities and to focus on how to generate additional revenue. From a business perspective, the benchmark/price cap regime makes it unattractive to add new programming services that are subject to regulation, or to rebuild systems to expand capacity or improve quality.

[redacted]

reasonable to expand and upgrade their systems.[2] As the *Order* itself acknowledges, expanded channel capacity will result in the provision of more programming to the public at lower prices.[3]

Viewed in this broad context, Discovery finds surprising the *Order*'s limitation of the flow-throughs of capital investment to the GNP fixed weight price index (GNP-PI), because it will so seriously hinder the achievement of this important public policy. Capital investment in system expansion and upgrades is typically the single largest investment incurred by cable operators. It is not reasonable to expect cable operators to recover capital investment in system improvements through rate adjustments intended merely to keep pace with inflation. Capital costs of the magnitude required for system improvements simply cannot and should not be treated as equivalent to routine business expenses that are subject to inflation. The GNP-PI measures price changes throughout the nation; it does not meaningfully reflect the cost of a once-a-decade capital investment by a cable company in system improvement. The GNP-PI constraint provides cable operators with neither an assurance of expense recovery nor an incentive to improve their systems.

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[2] Cable Television Consumer Protection and Competition Act of 1992 ("Cable Act"), § 2(b)(3).

[3] *Order*, Appendix E, Survey Results: Technical Issues, ¶ 27. Moreover, federal policy has historically favored infrastructure development, encouraging cable system delivery of broadband communications services. It has done so not only to allow American consumers to receive higher quality services at reasonable rates, but also to give American industry the necessary "home market" to compete internationally and better our international balance of trade. *See, e.g.*, initial Telecommunications Industry Association Comments in this docket at 16.

Nor will the benchmark regime account for these capital expenditures. Rate benchmarks are static snapshots of the industry taken as of September 30, 1992. They are unrelated to any factor other than the rates that were charged as of that day. Using rate benchmarks as a starting point from which increases are measured by a GNP-PI index presupposes that no significant changes to a static system. That assumption does not apply to

III. THE COMMISSION'S REGULATIONS SHOULD ALLOW CABLE OPERATORS TO FLOW-THROUGH EXTERNAL COSTS STARTING WITH THE EFFECTIVE DATE OF THE REGULATIONS.

As noted above, the benchmarks represent an analysis of the cable industry based on pre-October 1, 1992, data. Despite this, the Commission's *Order* does not allow costs incurred since then but prior to the date a cable system becomes subject to regulation -- when a franchise authority is certified and when a complaint about expanded basic rates is filed at the FCC -- to be passed through regardless of their exogenous nature. Rather, the cable operator is only permitted to cover all its costs in that period, both exogenous and endogenous, through a general inflation factor.

This treatment of post-October 1, 1992, costs is patently unfair. It denies, without explanation, the cable operator an opportunity to recover legitimate and proper costs.

Not only will this "gap" cause rates to be less than fully compensatory, but it will also create a perverse incentive for cable operators to delay incurring discretionary exogenous costs until they become eligible for recovery. As we are seeing, some operators are delaying even considering any new programming until after they are allowed to adjust their rates to pass through the corresponding additional costs. The result is a situation that discourages, not encourages, the availability to consumers of more diverse programming.

No public interest basis has been alleged, or exists, for denying cable operators the ability to recover exogenous costs during the period between the time that the benchmarks represent and when regulation begins. It will cause operators to operate at improperly reduced rate levels and undermine the ability of programmers to interest operators in taking new channels. Accordingly, Discovery urges the Commission to amend its rules and eliminate this unfairness.

IV. THE COMMISSION SHOULD ALLOW A FULL FLOW-THROUGH OF NET COSTS FOR NEW PROGRAMMING.

Section 76.722(d)(vi) provides that cable operators may flow-through as "external" costs the costs of programming, but only to the extent that they exceed the amount of increase in the GNP-PI. In those instances where the cable operator is "affiliated" with the cable programmer, the cable programmer is not even allowed that. It can only recover the additional revenue sources to compensate for cash flow reductions has made it difficult as a matter of business judgment to add programming channels on the basic or expanded basic tiers.

Indeed, the incentive for system operators now is to offer existing programming options and especially newly acquired program services only on an *á la carte* basis -- where no regulatory obstacles would exist to factoring a profit component into the price. Discovery submits that such a result is contrary to the public interest. Indeed, few if any program services, other than those expressly designed to operate as premium channels, could afford to survive on an *á la carte* basis.

As Discovery has demonstrated in its many filings in this proceeding, the economics of offering a service on an *á la carte* basis are very different from those associated with providing programs on a tier. *A la carte* services attract fewer subscribers and thus less subscriber and advertising revenue than channels placed on a tier. Moreover, the costs to promote significant awareness of a new channel's presence and attractiveness are very high. Accordingly, in order to survive, if indeed they can, programmers must charge cable operators (and indirectly subscribers) significantly higher prices for *á la carte* channels than for services offered on a tier basis.

To reverse the above predicament and give operators an incentive to add new program services to their cable system, the Commission needs to create a "profit incentive." This can be done by: (1) a percentage mark-up on program costs (approximately the same as a reasonable cost of capital) and (2) not requiring cable operators to subtract the GNP-PI from the programming pass-through calculation.

B. The Commission's Regulations Should Not Distinguish Between "Affiliated" Entities and "Unaffiliated" Entities In Treating Programming Costs As A Flow-Through Item.

The Commission's regulations impose an unfair distinction between programming costs incurred from affiliated and unaffiliated programming entities. While the *Order* treats programming costs from unaffiliated programmers the same as other external costs, as noted above it limits programming cost increases arising from programming obtained from affiliated entities.[5] This, in practice, precludes cable operators from fully recovering legitimate cost increases imposed by affiliated programming entities.[6]

The rule is unduly restrictive because it presumes without basis that vertically-integrated entities will use transfer pricing mechanisms to raise artificially the actual costs of programming to the cable operator. This presumption not only is unsupported by industry experience, but it also denies without reason a portion of a legitimate cost recovery to a cable operator that happens to be affiliated with a programming entity. Instead of the draconian presumption inherent in current Section 76.922(d)(vi), the Commission should allow cable operators to treat programming costs from affiliated entities in the same manner as costs imposed by unaffiliated programming entities.[7] If problems develop, significant remedial

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[5] *See* 47 C.F.R. § 76.922(d)(2)(vi).

[6] "Affiliated" is not synonymous with "control." In many instances affiliated programmers and cable systems will not be under common control.

[7] If the Commission believes that it must do something regardless of the tenuous and speculative nature of the harm, there are a number of more reasonable measures that could be taken. For example, a rule could be fashioned that applies only when the "affiliation" is one where an entity has a *de jure* control (50 percent or more stock ownership) and limits the affiliated cable operator to the same amount of increase as charged to non-affiliated systems of similar size.

options exist to remedy the situation. Sound public policy, however does not anticipate improper behavior -- especially when, as here, there is no history of such activity in the industry.

V. CONCLUSION.

Discovery recognizes the Cable Act's intent to drive down cable rates to consumers. However, Congress also intended for the Cable Act to accomplish other goals, including particularly the promotion of new and diverse programming. These goals are not achieved by policies that force cable rates to irrationally low levels.

Discovery believes that the Commission has taken too restrictive of a view of which costs can be treated as exogenous and how to calculate them. For that reason, Discovery respectfully suggests that the public interest would be served by adopting the changes proposed in this Petition.

Respectfully submitted,

DISCOVERY COMMUNICATIONS, INC.

By: Philip V. Permut

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Senior Vice President and
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